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Supreme Court of the United States

OCTOBER TERM, 1947

Nos. 184-9

IN THE MATTER

of

THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY, COMPANY,
Debtor.

THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY, COMPANY,
Debtor-Petitioner,

v.

METROPOLITAN LIFE INSURANCE COMPANY, as remaining member of the First and Refunding Group, CENTRAL HANOVER BANK AND TRUST COMPANY, *et al.*, as Trustees, THE NATIONAL CITY BANK OF NEW YORK, as Trustee, J. HAMILTON CHESTON, *et al.*, JOHN C. TRAPHAGEN, *et al.*, JAMES G. BLAINE, *et al.*,
Respondents.

ANSWER TO RESPONDENTS' "MEMORANDUM"

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New York, New York, September 29, 1947.

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Answer to Respondents' "Memorandum"

The debtor-petitioner regrets that it is necessary to ask this Court to consider this additional brief because of the unfounded statements and allegations in Respondents' recent Memorandum.

1. In Respondents' Memorandum (pp. 14-5) it is stated, for the first time, that the Commission in formulating the Rock Island plan did not estimate the normal annual income available for interest to be $11,000,000, but instead used that figure only in determining the amount of new income bonds to be issued in the reorganization.

The ICC was explicit upon this point; no cavil is possible. In the Commission's opinion of October 31, 1940 (242 ICC 298, 437) it said:

> "Despite such savings, the evidence of record convinces us that the estimate by the first and refunding committee of $12,500,000 of earnings available for interest in a normal year is somewhat too high. However, *earnings available for interest and dividends of approximately $11,000,000 in a prospective normal year are reasonably well supported by the evidence of record,* and particularly by the analytical traffic study presented by the first and refunding committee and the estimates of revenues and expenses based on such study." (Emphasis supplied.)

Moreover, the ICC this week submitted to the Senate Committee on Interstate and Foreign Commerce selected fiscal data relating to the Rock Island Railroad, and among these data is the item: "Normal year * * * Income available for interest * * * As adopted by ICC * * * $11,000,000."

The Report of the Trustees for 1945 filed with the district court on August 6, 1946, shows (p. 5737) the following interest requirements—contingent and fixed—under the plan now before this Court:

Interest on Equipment Obligations	$ 156,677.
Interest on First Mortgage Bonds	1,073,847.
Interest on assumed C. & M. Bonds	137,950.
Contingent interest on General Mortgage Income Bonds	3,330,322.
Total interest requirements under plan	$4,698,796.*

* This figure differs from the total interest requirements of $5,334,976 tabulated by the Commission (257 I. C. C. 319) because of a subsequent diminution in the securities to be issued under the plan, due to debt retirement.

If there is added to the foregoing interest requirements such sinking fund payments on both fixed and contingent interest bonds, compulsory capital fund payments under the plan, and dividends in full on the preferred stock, as are required under the plan, the following results are obtained:

Capital fund payment (257 I. C. C. 319)	$ 1,614,038.*
First Mortgage Sinking Fund (257 I. C. C. 319)	200,000.*
Income Bond Sinking Fund (257 I. C. C. 319)	400,000.*
Full dividend on 5% Preferred Stock (Trustees' Report for 1946, page 5737)	3,526,537.*
Total	$ 5,740,575.
Plus fixed and contingent interest......	4,698,796.
Total amount required for fixed contingent interest, dividends on preferred stock, and other charges	$10,439,371.

As demonstrated by the foregoing figures, the Commission in its allocation of preferred stock clearly erred in basing such allocation upon possible earnings of approximately $17,000,000, since its own estimate of $11,000,000 of earnings "in a prospective normal year" "available for interest and dividends" were sufficient to cover all preferred stock requirements. This error, committed by the Commission *prior* to *approval* of the plan, cannot be used by debtor-petitioner as a basis for reversal on this appeal; but, clearly, respondents cannot justify an error by reliance on another error.

* These capital fund and sinking fund requirements are based on the initial proposed issue of securities under the plan; a revision to reflect subsequent debt retirement would reduce these figures. The preferred dividend requirements include reductions due to debt retirement.

The record is clear: the Commission found that "earnings available for interest *and dividends* of approximately $11,000,000 in a prospective normal year are reasonably well supported by the evidence of record". Earnings of more than twice this amount in poor railroad years call for a reexamination of the situation.

2. The fact that earnings during the war years exceeded the post war earnings (Respondents' Memorandum, p. 13) is immaterial, since no effect was given to war earnings in the formulation of the plan. The important fact is that the post war earnings, during a period of depression in the railroad field, are more than two and one-half times the earnings on which the plan was predicated.

3. The figures (Respondents' Memorandum, p. 13) of the debtor's "earnings before interest" are incorrect because taxes are deducted before arriving at the figures given. Since taxes are deducted *after* payment of interest, "earnings available for interest" customarily are earnings before deduction of interest or taxes. On this basis, the earnings of the debtor available for interest were $58,137,708 in 1943, $59,915,919 in 1944, $39,088,810 in 1945, and $20,299,349 in 1946. Respondents understate the earnings of the debtor available for interest during this four year period by the enormous sum of $76,965,427.

4. The argument (Respondents' Memorandum, p. 13) that there should be no readjustment of the plan to benefit the unsecured claims of the holders of the convertible bonds because, under the plan, there is a $106,000,000 deficit in the recognition of some classes of secured claims, is clearly fallacious, for the following reasons:

(a) The argument assumes that secured creditors are entitled to full priority over unsecured creditors regardless of the value of their security, whereas the law is that such priority is limited to the value of their security. There is

nothing in the record to show that the value of the security of these classes of secured creditors is in excess of their claims; on the contrary, failure to pay them in full under the plan must have been predicated upon a finding that their security had a value less than the amounts of their claims.

(b) The argument disregards the large amount of cash and its equivalent which is now in the treasury of the debtor, of which $70,000,000 has been found by the District Court to be available for debt retirement. This was not available when the plan was formulated.

(c) The argument does not take into consideration that earnings at the annual rate of $27,757,056, available for interest, in a *sub*-normal period, instead of earnings of $11,000,000 estimated for a normal period, justify an increase in capital more than sufficient to make up the deficit. (The Commission authorized a capitalization of $368,000,000 on estimated earnings of $11,000,000.)

(d) The argument assumes that it is not the duty of this Court, the Commission and the debtor, despite the acquiescence of the so-called representative committees of these classes of secured indebtedness, to protect such classes by securing their payment in full under the plan, if they are entitled to such payment.

(e) The argument ignores the many millions of dollars invested during the pendency of the proceeding by capital improvements upon the properties upon which these secured creditors have their liens.

5. Respondents state (Respondents' memorandum, p. 18): "The Debtor, consistently with the position it has taken for many years, seeks further delay in carrying through this plan". The old cry: We have possession now; do not disturb, or even delay, our enjoyment of that possession by invoking the courts to secure an equitable readjustment of our respective rights!

August 1947 Earnings

The earnings of the debtor for August 1947 and for the first eight months of 1947 are now available. Net earnings in August 1947, available for the payment of interest, were 25% greater than for the same month last year. The net earnings available for the payment of interest (before the deduction of taxes) for the first eight months of 1947 were $18,504,702, or at the annual rate of $27,757,056—more than two and one-half times the anticipated earnings of $11,000,000 upon which the plan was based—and more than twice the annual interest of $12,525,036 accruing on *all* the *old* indebtedness, including the convertible bonds, in satisfaction of which only 17% is to be paid under the plan.

Here are the official figures:

EARNINGS OF ROCK ISLAND

January 1-August 31, 1947

Earnings (after deduction of depreciation, amortization, and federal income taxes, and before deduction of interest accrued but unpaid on the old bonds)	$14,584,702.
Federal income taxes (added to earnings because taxes are deducted after bond interest has been paid)	3,920,000.
Total earnings, for 8 month period, available for interest on bonds	$18,504,702.
1947 annual rate of earnings available for bond interest	$27,757,056.

Interest on the old convertible bonds was earned more than 11½ times during the first eight months of this year, as shown by the following figures:

Earnings available for interest	$18,504,702.
Interest on old bonds senior to convertibles	7,221,600.
8 months' earnings available for interest on convertibles	$11,283,102.
8 months' interest on convertibles	$ 968,400.

The 8 months' earnings available for interest on the convertibles is greatly in excess of the entire payment proposed in the plan for the full satisfaction of such convertibles.

Respectfully submitted,

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